No. 91-615

In The
Supreme Court of the United States
October Term, 1991

Allied-Signal, Inc., as successor-in-interest
to The Bendix Corporation,
Petitioner

v.

Director, Division of Taxation,
Respondent

On Writ of Certiorari to the Supreme Court
Of the State of New Jersey

BRIEF OF AMICI CURIAE ON THE MERITS IN SUPPORT OF DIRECTOR, DIVISION OF TAXATION OF THE STATE OF NEW JERSEY BY THE STATE OF CALIFORNIA AND THE STATES OF FLORIDA, IDAHO, KANSAS, MONTANA, NORTH DAKOTA, PENNSYLVANIA, UTAH AND WISCONSIN

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QUESTIONS PRESENTED

1. Whether the Due Process and Commerce Clauses preclude a state from apportioning income that a nondomiciliary corporation derives from the sale of its minority interest in another corporation, when the two corporations are not engaged in a unitary business and when the taxpayer fails to show that the holding of the minority interest arose as the result of activities discrete from the unitary business, a portion of which was carried on in the taxing state.

2. Whether this Court should now clarify, or should additionally articulate, the criteria it has set forth in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and related cases.

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INTEREST OF AMICI CURIAE

Amici are states which compute the individual tax liabilities of multijurisdictional taxpayers under the "unitary business principle" pursuant to the Uniform Division of Income for Tax Purposes Act, 7A Uniform Laws Annotated 331 (West 1985), hereinafter the Uniform Act. Under the provisions of the Uniform Act, income is divided between

"business income" which is subject to apportionment among the various states and "nonbusiness income" which is typically allocated or assigned to a single state.

New Jersey has not adopted the Uniform Act and its statute on its face does not distinguish between income which is apportionable and that which is specifically assigned to a particular state.[1] Nonetheless, amici share with New Jersey a common concern as to the limits upon State income taxation which arise from the Due Process and Commerce Clauses of the Constitution. In particular, amici are concerned with the standards for determining when income arising from the ownership of intangible property can be subjected to apportionment under the Due Process and Commerce Clauses of the Constitution and whether the Uniform Act meets those standards.

Amici have a particular interest in the clarification of the proper application of this Court's decision in *ASARCO Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and specifically whether or not it is necessary to establish that there is a "unitary business" relationship between the holder and the issuer of the intangible.[2] One, but not the only, way

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[1] Unlike the Uniform Act, New Jersey's statute does not distinguish between "business income" and "nonbusiness income." Under the New Jersey statute, all income is apportionable subject to the constraints of the Due Process Clause. Those constraints are similar to the considerations underlying the classification of income as "business income" because income cannot constitutionally be apportioned unless it arises from the activities of a unitary business.

[2] Confusion with respect to this question arose in part because of analytical concessions which this Court viewed Idaho as making and, in larger part, because the case as originally considered by the Idaho Supreme Court, *American Smelting & Refining Co.* v. *Idaho State Tax Com.*, 102 Idaho 38, 624 P.2d 946 (1981), was a "combined report" case involving

(continued...)

to establish the apportionability of the income arising from an intangible is if the holder and issuer of the intangible are in a "unitary business." More fundamentally, however, apportionability is established through the relationship between the intangible and the business of its owner. Amici have a direct interest in the clarification of this question which is involved in this case. A resolution of this issue involves hundreds of millions of dollars in state taxes annually.

STATEMENT PURSUANT TO RULE 37

This brief is submitted pursuant to Rule 37.3 of this Court in support of Respondent, the Director, Division of Taxation, State of New Jersey. Consent to the filing of this brief has not been requested from the parties because the amici filing this brief are the Attorneys General of their respective States. Rule 37.5 U.S. Sup. Ct.

SUMMARY OF ARGUMENT

This is another case involving the "unitary business principle." Unlike most "unitary business principle" cases reviewed by this Court, there is no question as to the fairness

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[2](...continued)
the question of whether various wholly owned subsidiaries were engaged in a "unitary business" with the parent. The question of the "business income" characterization of the dividends received from the affiliates was an ancillary question. Nonetheless, the "combined report" aspects of the case clearly became intertwined with the "business income" question. As explained in this brief, "combined reporting" is a "scope of the unitary business" analysis, and "business income" characterization is a type of tracing analysis which is applied after the scope of the unitary business is determined.

of the New Jersey apportionment method, no claim, or even suggestion, that the income attributed to New Jersey is out of all appropriate proportion to the business conducted in New Jersey, no claims of discrimination and none of multiple taxation. Petitioner claims only that New Jersey could not include this income in its apportionable base because it, the petitioner, and the entity in which it held a twenty percent stock interest were not engaged in a unitary business. This Court is now presented with the precise question which the parties conceded in *Mobil Oil Corporation* v. *Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO*, 458 U.S. 307 (1982) and *F.W. Woolworth Co.* v. *Taxation and Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982)—whether the classification of an item of income arising from an intangible as "business income," that is, "apportionable" income, requires a "unitary" relationship between the holder of the intangible and the issuer of the intangible.

The Uniform Act effectively tracks this Court's Due Process and Commerce Clauses analysis and, therefore, the New Jersey assessment here at issue can properly be analyzed under the Uniform Act in spite of the fact that New Jersey has not adopted it. Under the Uniform Act, the classification of income as "business income," or income subject to apportionment, is made by reference to the activities of the taxpayer or the unitary business. If the holder and issuer of the intangible are in a unitary business relationship, income from the intangible is invariably "business income." This is not, however, the only relationship which justifies "business income" classification. Many circumstances (see examples, *infra*, pp. 16-17) give rise to "business income" without the

necessity of a unitary relationship between the recipient and payor.

This Court's analysis in *ASARCO*, 458 U.S. 307; *Woolworth*, 458 U.S. 354 and *Mobil*, 445 U.S. 425, to the extent it focuses on the relationship between the payor and payee of dividends as solely determinative of the question of apportionability, was flawed and should not be applied in this case. The flaw in this analysis is graphically demonstrated in this case where the item of income involved is a capital gain. The issuer of the stock which was sold for a capital gain will never pay tax on the gain because it is never economically, or for tax purposes, viewed as the issuer's income. Such gain is only the income of the holder of the stock and it is only its activities which give rise to the gain or in any way relate to it. Amici request this Court to clarify the application of the "unitary business principle" to income arising from intangibles which are an integral part of a taxpayer's "unitary business" so that State courts can effectively and properly address this issue.

Petitioner is asking this Court to reverse a determination of the New Jersey courts, supported by an evidentiary record, that income arising from the disposition of a stock interest in another corporation was properly included in the income base which New Jersey subjected to apportionment. It is the petitioner which bears the burden of showing that the gain here at issue is unrelated to the unitary business, a part of which is carried on in New Jersey. It has failed to meet this burden.

Sustaining the New Jersey assessments in this case will not trivialize the "unitary business principle" and will not give rise to abusive taxation by the States. Petitioner has not

claimed it will be subjected to multiple tax burdens[3] and, therefore, is not seeking to avoid multiple taxation, but rather is asking this Court to provide it and other multijurisdictional taxpayers with an unwarranted shield from State taxation of income arising from intangibles which are part of its "unitary business."

The action of the New Jersey courts should be sustained.

ARGUMENT

I

INTRODUCTION

This case involves the review of a state income tax assessment under the "unitary business principle." The specific question presented is whether income received by a nondomiciliary taxpayer arising from the ownership of an intangible may be included in the income subject to apportionment by the taxing state. In *Mobil*, 445 U.S. 425, this Court stated "the linchpin of apportionability in the field of state income taxation is the unitary business principle." *Mobil*, 445 U.S. at 439. Proper analysis of the arguments submitted in support of and in opposition to the tax at issue requires a delineation of what is involved in the "unitary business principle."

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[3] The significance of this concession is that this is not a case where the State of commercial domicile, in this case Michigan, is taxing 100 percent of the income; therefore, no multiple taxation dispute exists.

The "unitary business principle" is a product of this Court's analysis of the constraints placed upon State taxation by the Due Process and Commerce Clauses of the Constitution. As described by this Court in *Container Corporation of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983), the "unitary business principle":

> "first defin[es] the scope of the 'unitary business' of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportion[s] the total income of that 'unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction." 463 U.S. at 165.[4]

There are three parts to the Court's description: (1) the scope of the unitary business (what activities constitute the unitary

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[4] The Court in *Container* continues by stating that "Two aspects of the unitary business/formula apportionment method have traditionally attracted judicial attention. These are, as one might easily guess, the notions of 'unitary business' and 'formula apportionment,' respectively." 463 U.S. at 165. This does not, of course, indicate that these are the only two elements or questions involved in a "unitary business" analysis. To the extent the Court's decisions in *Mobil*, 445 U.S. 425; *ASARCO*, 458 U.S. 307 and *F. W. Woolworth*, 458 U.S. 354, are to be considered to fall within the first class, amici submit it is only because of the concessions of the litigants and the analysis applied in those cases, not because of their true nature. See *infra*, pp. 14-21.

business), (2) the income arising from such activities, and (3) the apportionment formula.[5]

The focus of the Court's inquiry into the scope of the "unitary business" is upon activities. The question of whether a state can consider income arising out of extraterritorial activities is determined by whether there is "a 'minimal connection' or 'nexus' between the interstate activities and the taxing state." *Exxon Corporation* v. *Wisconsin Department of Revenue*, 447 U.S. 207 at 219 (1980) (emphasis added). "[T]he principles we have quoted [Due Process and Commerce Clause] require that the out-of-state activities of the purported 'unitary business' be related in some concrete way to the in-state activities." *Container*, 463 U.S. at 166 (emphasis added).

The scope of the "unitary business" can, as it is by New Jersey, be determined by reference to the activities of a single corporate entity (see, e.g., *Exxon*, 447 U.S. 207) or by reference to a group of commonly owned and controlled entities as it is in a combined report jurisdiction (see, e.g., *Container*, 463 U.S. 159). As this Court pointed out in *Container*, "there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." 463 U.S. at 167.

Once the scope of the "unitary business" has been established, the second inquiry focuses on whether the income arises out of interstate activities. It has long been settled that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned . . . [citations omitted]." *Exxon*, 447 U.S. at 219. To be

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[5] The parties are in agreement that there are no questions concerning the application of the apportionment formula in this case.

considered in the tax base, or to be taxed, the item of income must be the taxpayer's. The activities to be considered in determining whether the income is apportionable are the activities of the taxpayer and, more particularly, the activities of the unitary business, a part of which is conducted in the taxing state. If the income arises from activities which are not part of such a unitary business, then there is no concrete connection which authorizes the State to consider the item of income in determining its tax.

In the *Container* case, the Court pointed out that the Uniform Act is one of the forms which the unitary business/formula apportionment method has taken and that it is used by a significant number of the States. 463 U.S. at 165. Specifically, the Court noted that the

> "Uniform Act . . . track[s] in large part the principles [Due Process and Commerce Clause] we have just discussed. In particular, the statute distinguishes between the 'business income' of a multijurisdictional enterprise, which is apportioned by formula, [citations to the California Statutes], and its 'nonbusiness' income, which is not. Although the statute does not explicitly require that income from distinct business enterprises be apportioned separately, this requirement antedated adoption of the Uniform Act, and has not been abandoned." (Footnotes omitted.) 463 U.S. at 167 (emphasis added).

Based upon this Court's statement that the Uniform Act, and in particular California's application of the Uniform

Act, to a large extent "tracks" its analysis and application of the Due Process and Commerce Clause constraints which have given rise to the "unitary business principle," amici will analyze this case under the provisions of the Uniform Act. Amici will use the term "business income" as meaning income subject to apportionment, that is, as income which under this Court's analysis may be considered by the taxing state.[6]

II

THE DETERMINATION OF WHETHER INCOME IS BUSINESS INCOME, OR APPORTIONABLE, IS MADE SOLELY BY REFERENCE TO THE RELATIONSHIP OF THE ITEM OF INCOME TO THE TAXPAYER'S ACTIVITIES

The Uniform Act defines "business income" as:

> "[I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." Section 1(a).

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[6] Under Section 9 of the Uniform Act, all business income is subject to apportionment. "The linchpin of apportionability . . . is the unitary business principle." *Mobil*, 445 U.S. at 439. Ergo, business income arises from the unitary business.

The definition establishes the "business income" relationship by reference to the "taxpayer's trade or business."[7] There is no reference to the trade or business of anyone else.

The definition is applicable regardless of whether the income arises from "tangible" or "intangible" property. No different test is set forth based on the nature of the property. It is not the nature of the property involved but the relationship of the item of income to the taxpayer's activities which controls. The definition of "business income" does not turn upon the type of income involved. There is no reference in the definition to dividends, capital gains, interest, royalties, operating income or any other type of income. Again, the "business income" characterization is based upon the relationship of the item of income to the taxpayer's activities.

The definition also states that "business income" can arise from the property itself and from the "acquisition, management, and disposition" of the property. The only requirement is that the acquisition, management and disposition of the property be part of the taxpayer's regular (unitary) trade or business. Because of this, California, and many other states which have enacted the Uniform Act, view the definition of "business income" to contemplate two separate but complementary tests—a transactional test and a functional test. The satisfaction of either one of these tests results in the classification of a particular item of income as

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[7] In a "combined report" state such as California, for purposes of determining the scope of the unitary business, the business or nonbusiness character of income and the apportionment formula, the term "taxpayer" includes all commonly owned and controlled entities. In the case of New Jersey and other states, it involves a single entity. The analytical principles are similar, however.

"business income," or income which is subject to apportionment.

The transactional test is satisfied when the income arises from a transaction or activity in the regular course of a taxpayer's trade or business. Classic examples of transactional "business income" include the sale by a manufacturing company of the product which it manufactures, the sale of crude oil or refined product by an oil company, and the sale of merchandise by a retailer. The transactional nature of an item of income is determined by reference to the business of the taxpayer. Therefore, a bank realizes "business income" from its return on the investment of customer deposits whether it arises from interest on loans, credit card fees or the holding of government securities.

The "functional" test is satisfied when the income arises from the "acquisition, management and disposition" of an asset which is held as part of or in the course of the unitary business. This test is necessary to deal with the "unusual" event. An example is a manufacturing company that constructs a new plant and sells an old plant. It is not in the regular business of buying and selling plants, but the plant is necessary to the operation of its business. Under the functional test, the proceeds on the disposal of the plant constitute "business income" even though the disposition of the plant did not occur as a routine, periodic part of the regular business activity. Use of the "functional" standard requires that consideration be given to the relationship between a taxpayer's property, tangible or intangible, and the taxpayer's business operations in order to determine whether the income arising therefrom is "business income." If the taxpayer is engaged in a unitary business, then the inquiry into its "business" necessarily involves inquiry into its "unitary

business." This consideration is necessitated by the Due Process requirement of a minimal connection between the item of income and the activities in the state. In the case of intangibles, if the property which gives rise to the income is integrally related to the unitary business activities of the taxpayer, it is "business income." If part of the activities of the unitary business take place in a non-domiciliary state, then the "business income" of the taxpayer, including income from intangibles, is subject to apportionment by that state.

An item of income may satisfy both the transactional and functional tests. An example of such "business income" is the interest arising from the short-term investment of working capital. The taxpayer, unless it is a bank or similar entity, is not in the business of investing money, but it is in the business of regularly and routinely obtaining a return on its idle assets pending their use in the unitary business. Frequently, such funds are invested in short-term securities.[8] This interest is routinely classified as "business income" by both taxpayer and tax administrator, and properly so.[9]

In the course of the last decade and a half, this Court has given extensive consideration to the "unitary business principle" as it affects state income taxation. The principal decisions of this Court which consider the question of what constitutes a unitary business and what is "business income" are *Mobil*, 445 U.S. 425; *Exxon*, 447 U.S. 207; *ASARCO*, 458 U.S. 307; *Woolworth*, 458 U.S. 354; *Container*, 463 U.S. 159; *Shell Oil Company* v. *Iowa Department of Revenue*,

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[8] The taxpayer has no concern with whether it realizes income as interest, dividends or gains. It seeks the maximum return, commensurate with safety, over the period of investment.

[9] See, e.g., JA p. 13; *American Home Products Corp.* v. *Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201 (Oh. 1990).

488 U.S. 19 (1988); and *Amerada Hess Corp.* v. *New Jersey Department of Treasury*, 490 U.S. 66 (1989).

Exxon (divisions of a single corporation) and *Container* (parent and subsidiaries) directly involved the scope of the unitary business. Those cases were correctly analyzed and decided on that basis. In both cases, the question presented to the Court was whether or not activities taking place outside of the taxing jurisdiction could be considered in determining the income apportionable to the state.

Amerada Hess and *Shell* were "business income" cases, where the question presented was whether a particular expense or receipt of the unitary business, a "windfall profits" tax and Outer-Continental Shelf income, respectively, could be separated when they did not directly arise from the activities in the taxing state. The Court stated in *Amerada Hess*:

> "Appellants, however, underestimate the fact that, for apportionment purposes, it is inappropriate to consider the windfall profit tax as an out-of-state expense. Rather, just as each appellant's oil-producing revenue—as part of a unitary business—is not confined to a single State [citations omitted], so too the costs of producing this revenue are unitary in nature." 490 U.S. at 74.

Mobil, *ASARCO* and *Woolworth* are also "business income" cases. Each of these cases considered the question of whether dividends received by a nondomiciliary taxpayer could be included in apportionable or "business income." However, these cases were analyzed as if they involved the scope of the unitary business, that is, whether the activities

conducted by the payors of the dividends in those cases were part of the unitary business conducted by the recipient of the dividend payment. This analytical framework arose as a result of "concessions" made by the losing party.[10]

This Court's focus on the scope of the unitary business to the exclusion of the consideration of whether the items of income at issue arose from activities of the unitary business was analytically flawed. *Mobil* was correctly decided and its result was unaffected by application of the flawed analysis because one of several ways to establish that dividends are

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[10] In the *Mobil* decision, the Court, after commenting on the lack of evidence in the record, noted:

> "many of these subsidiaries and affiliates [the dividend payors], including the principal contributors to appellant's dividend income, engage in business activities that form part of Mobil's integrated petroleum enterprise. Indeed, although appellant is unwilling to concede the legal conclusion that these activities form part of a 'unitary business'. . . it has offered no evidence that would undermine the conclusion that most, if not all, of its subsidiaries and affiliates contribute to appellant's worldwide petroleum enterprise." 445 U.S. at 435.

In *ASARCO*, the Court stated "Neither does it [Idaho] question that a unitary business relationship between ASARCO and these subsidiaries [the dividend payors] is a necessary prerequisite to its taxation of the dividends at issue." 458 U.S. at 325. It should also be noted that in the Idaho Supreme Court, the primary issue was the combined reporting treatment applied to the unitary subsidiaries. The treatment of the dividends was only an ancillary issue. *American Smelting & Refining*, 624 P.2d 946 (1981).

In *Woolworth*, the Court reviewed the New Mexico Supreme Court's analysis of whether a unitary business relationship between payor and payee was necessary and found that the application of this analysis (whether the payor and payees were unitary) by the New Mexico Supreme Court was flawed without considering whether the species of analysis applied was the proper one. 458 U.S. at 360.

"business income" is to show that the payor and payee are part of the same unitary business and because Mobil did not focus on its minority shareholder status and, therefore, its inability to control the dividend payor. In *ASARCO* and *Woolworth*, however, application of the flawed analytical framework precluded the States from being able to sustain their assessments and led to an erroneous conclusion by the Court.[11]

Consideration of several examples illustrates the point that a unitary relationship between the payor and payee is not necessary for finding an item to be "business income":

> Example 1: A manufacturing business sells its product to an unrelated third party. The transaction gives rise to "business income."
>
> Example 2: A bank lends money to an unrelated third party and receives interest as a result. The interest is "business income."
>
> Example 3: An investment company receives dividends from the investment of its capital in a 10-percent interest in each of three unrelated companies. The dividends are "business income."
>
> Example 4: A department store purchases the corporate securities of a third party with the

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[11] For an excellent discussion of the analytical problems presented, see "The Supreme Court 1981 Term," 96 *Harv.L.Rev.* 62, in particular pp. 93-96.

proceeds from its sale of merchandise to third parties at Christmas. The obligations are sold prior to the next Christmas to replenish inventories. The interest, dividends or capital gains realized are "business income."

Example 5: A drug company develops and patents a new drug. It manufactures and sells the drug in the United States and also licenses unrelated third parties to manufacture and sell the drug world wide. The proceeds from its own sale of the drug and the license fees received are all "business income."

Example 6: A petroleum company purchases a substantial minority interest in a corporation operating an oil concession to obtain an assured source of crude oil. Proceeds from the purchase and resale of the crude and the dividends received from the ownership of the minority stock interest are "business income."

In none of these examples is the recipient of the payment in a unitary business relationship with the maker of the payment, yet virtually all state tax administrators and taxpayers would agree that all of the receipts were "business income" within the meaning of the Uniform Act and thus apportionable among the parts of the taxpayer's unitary business.

The "requirement" that there be a unitary business relationship between the payor and payee arose in cases

involving the classification of dividend income.[12] An examination of the treatment of capital gains, however, illustrates the fallacy of the requirement of a payor/payee unitary relationship. This is not to say that dividends and capital gains require a different analysis or that a different result is required depending on the type or receipt. To the contrary, what it establishes is that the analytical framework used for the dividends in *ASARCO* was faulty because it is inapplicable to capital gains.

With respect to dividends, it is possible to argue that the income arises from the activity of the payor because there would be no dividends if the payor had no earnings.[13] If the payor had earnings, then it has been, or at least could have been, taxed on those earnings when they arose.[14] In the case of capital gains arising from the ownership of stock, however, the issuer of the stock has no earnings when the stock is

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[12] Only in *ASARCO* was any question raised as to the classification of other types of receipts from intangibles. In *ASARCO*, the proper classification of capital gains realized on the sale of the stock of one of the dividend-paying subsidiaries and interest received as the result of the sale of another of the subsidiaries was ostensibly at issue. But as the Court noted, "Idaho and ASARCO agree that interest and capital gains income derived from these companies should be treated in the same manner as the dividend income." 458 U.S. at 329. The Court indicated its agreement in four brief sentences.

[13] In a tax sense, dividends can only arise if the statutory requirements of either accumulated earnings or profits or current year's earnings or profits are met. See, e.g., § 316 Internal Revenue Code, 26 U.S.C. § 316.

[14] It should also be noted, however, that it is the earning of income which is taxed to the payor. The payment from that income of dividends is not a taxable event to the payor; it is only a taxable event to the payee. This illustrates the mischief which can arise if activities outside of the unitary business are considered in determining whether an item of income is "business income" to the recipient. It is this analytical flaw which appears to explain the dissent filed in *Mobil*, 445 U.S. at 449-462.

bought and sold by the third parties. The gains realized, or losses sustained, may reflect the outside world's view of the results of the issuer's activities, or they may have no relationship whatsoever. But the point to be made is that the third-party seller is the only entity which has income, in both a taxable and economic sense, and therefore is the only entity which can be assessed a tax on those results. In the case of capital gains, as contrasted to dividends, there is neither a technical, nor economic, argument which superficially supports consideration of the activities of the issuer of the stock in apportioning the income. It is only the activities of the holder of the stock which should, and which need to, be considered.[15]

The Uniform Act characterizes income as "business income" or "nonbusiness income." It defines "business income." Section 1(a). "Nonbusiness income" is "all income other than business income." Section 1(e). The presence of the two terms makes it clear that a taxpayer may have both types of income, and the exclusionary nature of the nonbusiness definition makes it clear that there are no other types of income.

Under the Uniform Act, the determination of whether income is "business" or "nonbusiness" is made by reference to the activities of the taxpayer. It is the corporation which establishes what the business of the corporation is, determines whether an activity is in the course of the regular business of the corporation, and determines whether a particular item of property is acquired, managed and disposed of as part of the

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[15] The point is also made in the case of interest and royalties. Not only does the payor not have income, but, in fact, it receives a deduction.

regular business. This Court, consistent with the Uniform Act, recognized that not all income is "business income" or income subject to apportionment. It properly held in *Woolworth* that a standard which treated all income as business income

> "would trivialize this due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation. . . .' [Citations omitted.] Income, from whatever source, always is a 'business advantage' to a corporation. Our cases demand more." 458 U.S. at 363.

This Court in *ASARCO* rejected too hastily "corporate purpose" as the test. 458 U.S. at 326-329. "Corporate purpose," correctly defined, is the proper standard for determining apportionability. "Corporate purpose" has meaning in the context of the Uniform Act when it is understood as being controlled by the purpose for which the corporation holds the asset.[16] If the taxpayer holds itself out as actively engaged in acquiring, managing and disposing of intangibles as part of its operational business strategy and in furtherance of its operating business, then a state can, consistent with the requirements of Due Process analysis, conclude that it is generating "business income" from such activities. Passive investments do not give rise to "business income." "Purpose" is not just having a profit motive, but

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[16] Perhaps the term "unitary purpose" or "business purpose" more accurately captures the Uniform Act distinction between "business" and "nonbusiness" income.

instead is defined by the "unitary business" of the taxpayer. This definition is consistent with the Uniform Act. Petitioner decries this as a "unitary business doctrine defined largely by corporate rhetoric." (Appellant's Opening Brief, hereinafter AOB, p. 35.) But what is wrong with a State relying upon an admission by a taxpayer in determining its tax if it chooses to do so?

III

THE PETITIONER HAS NOT ESTABLISHED THAT THE CAPITAL GAINS HERE AT ISSUE AROSE FROM A DISCRETE BUSINESS ENTERPRISE CONDUCTED BY PETITIONER

This Court has stated on numerous occasions and reaffirmed in *Container*, which was decided subsequent to *ASARCO* and *Woolworth*, that:

> "the taxpayer always has the 'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed.' [Citation omitted; insertion by the Court.] One necessary corollary of that principle is that this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary business.' As we said in a closely related context in *Norton Co.* v. *Department of Revenue* [citation omitted]:

> 'The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.
>
> 'This burden is never met merely by showing a fair difference of opinion which as an original matter might be decided differently . . . . Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence.' [Citations omitted.] (footnotes omitted; emphasis added)." 463 U.S. at 175-176.

This is the burden which the petitioner must carry in this case. If the judgment of the New Jersey courts is supported by substantial evidence, then this Court should sustain their findings in spite of the fact that a different result could be reached.

In *Mobil*, 445 U.S.at 435, and *Woolworth*, 458 U.S. at 360, this Court commented on the scanty evidence in the record. Amici, based upon their review as non-parties, do not believe the record in this case can be so characterized. There is substantial evidence which supports the conclusion of the New Jersey courts that the capital gains did not arise in the

course of a discrete business enterprise conducted by the taxpayer.[17]

Not only has the petitioner failed to carry its burden, but New Jersey has affirmatively established the required linkage. Review of the factual record in this case shows that the petitioner treated its activities regarding ASARCO as a discrete business in one instance and for a single purpose—-to exclude the capital gain it realized on the sale of its interest from the income subject to apportionment by New Jersey. In all other aspects, the petitioner treated its activities regarding ASARCO, and the income and expense arising therefrom, as part of its single unitary business, a portion of which was conducted in New Jersey. These other aspects include the following:

- Bendix did not file on a lines-of-business approach in New Jersey in spite of the fact that only two of its four lines of business were present in New Jersey. (Stip. ¶11, Joint Appendix, hereinafter JA, pp. 154-155; Stip. ¶¶31-38a, JA pp. 161-163.)

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[17] Amici note that the parties have stipulated that ASARCO and the petitioner are not in a unitary business. As explained in the preceding section, that is not determinative of the outcome of this case. The relevant inquiry is whether petitioner has shown by "clear and cogent" evidence that the capital gains which arose as a result of the petitioner's activity have been shown to be unrelated to the activities of petitioner's unitary business, a part of which the petitioner carries on in New Jersey.

- Bendix did not remove the value of the ASARCO stock from its calculation of net worth which was also subject to an apportioned New Jersey tax.[18] (Stip. ¶4, JA p. 153.)

- Bendix borrowed money, over $100 million, to purchase the ASARCO stock and there is no evidence that it did not deduct the interest expense associated with this borrowing from its unitary income otherwise subject to New Jersey's apportionment. (Stip. ¶52, JA p. 167.)

- Bendix received dividends from its interest in ASARCO which it no longer contends should not be included in the income subject to apportionment. (JA p. 13.)

- There is no evidence that Bendix allocated any of its corporate overhead, including the salaries of William Agee and the Corporate Acquisition group, as separate from the base subject to New Jersey's apportioned tax.

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[18] The "unitary business principle" and apportionability do not apply only in the income tax setting. The principle first arose in property taxation, and in this last term was applied to the Michigan Single Business Tax. *Trinova Corp.* v. *Michigan Treasury Dept.*, 498 U.S. ___, 111 S. Ct. 818 (1991).

- There is no evidence that Bendix reported the capital gain as other than a part of the apportioned base for purposes of the taxes asserted by the State of Michigan, its commercial domicile, or assigned the capital gain on any basis, other than an apportioned basis, to any other state.

- Bendix no longer contests that all other capital gains and losses were apportionable income. (JA p. 13 & Petition for Certiorari.)

- Bendix no longer contests that the income arising from the investment of the proceeds of the sale of its interest in ASARCO gave rise to apportionable income. (JA p. 13.)

Each of these items goes to show that the Uniform Act definition of "business income" is met and therefore the income is classifiable as "business income." The sale of the ASARCO stock, given the other business activities entered into by the petitioner (see Stip. ¶¶128-157, JA pp. 183-192), was a transaction in the regular course of the petitioner's trade or business. The "acquisition, management and disposition" of the stock interest was an integral part of the petitioner's business.

Each of these items provides support for the determination of the New Jersey courts that this income can

be considered in the apportionable base and should cause this Court to sustain their determination.

IV

THIS COURT NEEDS TO CLARIFY THE CONFUSION CREATED BY ITS DECISION IN *ASARCO*

Amici agree with the petitioner that this Court should clarify its decision in *ASARCO*. (AOB Questions Presented 2., p. i). It is unlikely that amici and the petitioner would agree with the direction this clarification should take. Amici certainly disagree with the petitioner's contention that an affirmation of the lower court's decision would lead to egregious results.

ASARCO and *Woolworth* have been the subject of substantial unfavorable comment by scholars in the field of state taxation.[19] But what is of more importance, these decisions and the analysis of *Mobil* and the dissent therein

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[19] Walter Hellerstein, "State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication." 41 *Tax Lawyer* 37 (1988); Nancy A. Kelley, "The Unitary Tax Method: Are the Factors Used by California in the Determination of Unity Still Viable after *ASARCO* and *Woolworth*?" 15 *Pacific Law Journal* 109 (1983); Joel M. Greene, "*Asarco* and *Woolworth*: Anomalous Anachronisms with Limited Precedential Value," 18 Tax Notes No. 10 at 795 (March 7, 1983); Walter Hellerstein, "State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on *ASARCO* and *Woolworth*," 81 *Michigan Law Review* 157 (1982); Richard A. Hanson, "*ASARCO* and *Woolworth*—Refining *Mobil* and the 'Unitary Business' Test for Apportioning Intangible Income," 1 *Journal of State Taxation* 197 (1982); C. Douglas Floyd, "The 'Unitary' Business in State Taxation: Confusion at the Supreme Court?" 1982 *Brigham Young University Law Review* 465.

have led the state courts down a variety of paths including blind adherence[20], neglect[21], distinction[22], tortured avoidance[23], and well reasoned dissents[24]. The difficulty the states are having with this issue is reflected in recent petitions filed with this Court.[25]

This area of tangled jurisprudence can be clarified by recognition of the fact that two separate analytical frameworks are required in determining the scope of the unitary business and whether a particular income item results from operation of the unitary business.

Dividends received from a subsidiary or affiliate which is within the scope of the unitary business clearly can

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[20] *Corning Glass Works, Inc.* v. *Virginia Department of Taxation*, 241 Va. 353, 402 S.E.2d 35 (Va. 1991); *Pledger* v. *Illinois Tool Works, Inc.*, 306 Ark. 134, 812 S.W.2d 101 (Ark. 1991); *Brunner Enter., Inc.* v. *Department of Revenue*, 452 So.2d 550 (Fla. 1984).

[21] *Lone Star Steel Co.* v. *Dolan*, 668 P.2d 916 (Colo. 1983).

[22] *NCR Corp.* v. *Comptroller*, 313 Md. 118, 544 A.2d 764 (Md. 1988); *NCR Corp.* v. *South Carolina*, 402 S.E.2d 666 (SC. 1991); *NCR Corp.* v. *Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1988); and *Williams Companies* v. *Director of Revenue*, 799 S.W.2d 602 (Mo. 1990).

[23] *American Home Products Corp.* v. *Limbach*, 49 Ohio St. 3rd 158, 551 N.E.2d 201 (Oh. 1990); *American Telephone & Telegraph* v. *Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 (Wis. 1988).

[24] *Pledger* v. *Illinois Tools*, 306 Ark. 134, 812 S.W.2d 101 (Ark. 1991); *Tambrands, Inc.* v. *State Tax Assessor*, 595 A.2d 1039, ___ N.E.2d ___ (Me. 1991); *NCR Corp.* v. *South Carolina*, 402 S.E.2d 666 (SC 1991); *Williams Companies* v. *Director of Revenue*, 799 S.W.2d 602 (Mo. 1990); *Dow Chemical Company* v. *Director of Revenue*, 787 S.W.2d 276 (Mo. 1990).

[25] *Pledger* v. *Illinois Tool Works, Inc., cert. denied*, ___ U.S. ___, 112 S. Ct. 418 (1991); *Corning Glass Works, Inc.* v. *Virginia Dep't of Taxation, cert. denied*, ___ U.S. ___, 112 S. Ct. 277 (1991).

constitutionally be treated as "business income."[26] But Amici respectfully submit that this is not the only basis upon which dividends and other income from intangibles can give rise to "business income." The key relationship or link which must be made is between the acquisition, management and disposition of the income-producing intangible which produces the item of income and the activities of the unitary business. Recognition and acceptance of this principle by this Court will clear the tangled brush. The petitioner argues against this result on the basis of the doctrine of stare decisis (AOB p. 41) but provides no analytical support. This lack of analysis characterizes the lack of vitality of petitioner's entire attack on New Jersey's assessment.

Petitioner decries what it sees as the consequences of this Court sustaining New Jersey's determination, the apportioned consideration of income from intangibles in the tax base of all states. (AOB Argument E, pp. 40-42). What is wrong with this result? A possible consequence in some cases, but not here, might be multiple taxation, in full by the state of domicile and on an apportioned basis by all other states, but only if the Court were not prepared to adjudicate the issue. Petitioner is not concerned about multiple taxation, as shown by its failure to raise that issue in this case, but rather with the loss of its ability to shield significant portions of its income from state taxation.

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[26] If the requisite ownership and control is present, California would "combine" the two corporate entities and compute the California tax of each by reference to a "combined report"; under these circumstances, California would not include in unitary net income any dividends passed within the unitary group of corporations. This Court has recognized that such variations are permissible. *Container*, 463 U.S. at 167.

CONCLUSION

The Court should clarify the analytical framework of the "unitary business principle." The question of the scope of a unitary business is a different inquiry from the determination of whether an item of income arises from the activities of the unitary business once that scope is determined. In *Container*, this Court took a step back from its decisions in *ASARCO* and *Woolworth* and reaffirmed its earlier precedents concerning the evidentiary duties of taxpayers and tax administrators. Now the Court needs to step back from these decisions again in order to return reason to the analytical framework of the "unitary business principle." The circumstances of this case, wherein a state is seeking to apportion capital gain income by reference to the activities of the only entity which can ever be taxed on this income, crystallizes this difference in a way cases involving the taxation of dividends never can.

The petitioner in this case has refused to recognize and accept its burden of showing that the sale of its interest in ASARCO was unrelated to the business which it partly carried on in New Jersey. In contrast, even though the State does not bear the burden, New Jersey has shown that the petitioner

treated its interest in ASARCO as an integral part of its business. The action of New Jersey should be sustained.

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Respectfully submitted,

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